



Main Street Coalition for Postal Fairness

April 7, 1998

John T. Estes
Executive Director

The Honorable John M. McHugh
Chairman
Subcommittee on Postal Service
The House of Representatives
Washington, DC 20515

MEMBERS

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American Bankers Association

American Business Press

Cahners Publishing Company

**Coalition of Religious Press
Associations**

Greeting Card Association

Hallmark Cards, Inc.

Knight Ridder, Inc.

Miller Freeman, Inc.

National Federation of Nonprofits

National Newspaper **Association**

National Rural Electric
Cooperative Association

Newspaper **Association** of America

PennWell Publishing **Company**

Penton **Publishing Company**

Tribune Company

Dear Mr. Chairman:

On behalf of the Main Street Coalition for Postal Fairness (MSC), I thank you for the opportunity to comment on your revisions to H.R. 22 (the Bill) as distributed with your letter of December 11, 1997. On a number of occasions representatives of our member organizations have met with the Subcommittee staff to discuss in detail the revisions. MSC views this most recent revision as a positive step forward in the evolution of the Bill. It incorporates a number of reforms, many of which we supported in subcommittee hearings and in discussions with you and your staff. We wholeheartedly endorse the following provisions:

- a) A Postal Rate Commission renamed the Postal Regulatory **Commission (PRC) with expanded jurisdiction and use of** subpoena authority is a major step forward;
- b) Moving ahead with a Postal Management Commission to address serious labor management issues at the USPS;
- c) Relaxing current restrictions on Postal Service banking procedures to permit a more responsive financial management procedure at the USPS;
- d) **With** certain reservations noted below, movement toward a clearer and more responsive price cap system including an exogenous price index and an "X" factor based solely on a relevant measure of productivity; and
- e) Various administrative improvements relating to law **enforcement, transportation and personnel matters.**

We are encouraged by this progress and will work toward resolving with your Subcommittee those remaining troublesome provisions of the Bill to enable us to move forward with you toward the goal of effective and meaningful postal reform

We should also state at the outset, however, that the Bill proposes that First Class mail be divided into baskets for differential pricing purposes... a concept that is discussed below and which we are unable to support. We disagree with the attempt to reverse the Postal Rate Commission's decision that single piece and other First Class letter mail **should remain a single subclass.** ~~As there are serious public policy issues~~ raised by the proposal to establish a for profit private corporation to engage in any postal or non-postal business.

As a word of caution, the comments that follow are necessarily **preliminary until we have been able to carefully review the legislative** language which we understand from Mr. Taub will be available in the near future. Our coalition, estimated to represent 40 percent of the annual volume of the Postal Service, **respectfully** requests an opportunity to **furnish** you and the other members of the Subcommittee with our final comments and recommendations prior to any Subcommittee mark-up. Due to the overwhelming impact the Bill will have on the postal community, we also **request that our final comments be submitted on the record at a** Subcommittee legislative hearing. In the development of essential legislative history, there is no substitute for a dialogue with the Subcommittee, particularly with respect to those new and recently added provisions in the Bill that have not been previously considered at a Subcommittee hearing. We believe any process short of that goal would short change our members.

MSC's preliminary comments on the Bill's concepts are as follows:

Title One - Organization... We wholeheartedly support changing the name of the Postal Rate Commission to the Postal Regulatory Commission **in recognition of the regulatory and other responsibilities the** Bill would grant to the PRC.

Furthermore, we believe names or titles should appropriately reflect duties and responsibilities. For that reason MSC members question changing the name of the Board of Governors to "Board of Directors", designating the Postmaster General as the "Chief Executive Officer", and renaming his Deputy as the "Deputy Chief Executive Officer." As a federal agency, the Postal Service is a public institution and must have as its primary focus a commitment to public service. Postal Service participation in private sector ventures should be incidental and subordinate to that public service mission. It is irrelevant that the term "Chief Executive," for example, may have been used inappropriately and contrary to current law by Postal ~~Service executives in the recent past.~~ **It may be better not to change** the names of these officials or at a minimum conform those changes to the

fact that this authority remains basically unchanged. Otherwise, changes in title designations would be misleading and could result in erroneous claims for expanded authority inconsistent with the Postal Service's legal authority and the public service mission.

We support the other proposals in Title One.

Title Two - General Authority...Some MSC members have serious reservations and would oppose the involvement and expanded jurisdiction of the U.S. Trade Representative as the spokesperson of the United States before inter-governmental organizations concerning postal matters.

Title Three - Postal Employee Management Commission.. MSC supports title three. Clearly something needs to be done in this area, and the proposal to involve an independent commission appears to be a **useful** start in the right direction. Although time is of the essence in addressing this issue, it may be desirable to consider deferring this effort until after ~~major union negotiations scheduled to start this autumn have been~~ completed.

Title Four - Finance.. MSC supports the reforms addressing Postal Service banking depositories and proposals regarding investments in U.S. government obligations.

An analysis of the proposed Postal Service Competitive Products Fund in the absence of legislative language is particularly difficult to make. Without endorsing bifurcation of Postal Service products into competitive and noncompetitive categories and the ensuing penetration by the Postal Service into the private market, MSC believes the effort in the Bill to prevent any cross pollination between the two groups is appropriate and **also essential**.

Our difficulty in analyzing the competitive funds proposal stems from the ambiguity that "...competitive products collectively must bear at least an **equalproportion** of institutional costs as non-competitive products." The concept that competitive products as a group should bear the same percentage of overhead costs as noncompetitive products as a group is **in theory** a fair and equitable approach. There are basic questions, however, about the practical application of such a proposal particularly when there is a sharing of common and, in some cases, **fungible** overhead costs involving both of the product categories. We are also concerned that what may appear to be reasonable on a quantitative basis today may be far less so in the **future** if substantial segments of mail are later shifted into, or ~~out of the competitive category~~. Without further study and a review of the final language in the Bill, we have difficulty in determining fair and equitable

treatment of each category. Nevertheless, we remain hopeful that the legislative language will address this problem.

Finally, the Subcommittee should reconsider whether it would be appropriate to authorize Competitive Products Fund borrowings from the Postal Service Fund, even on an arms length basis at market rates and terms. There are two basic problems here. First, why should the Postal Service Fund, comprising resources contributed by mailers of non-competitive postal products, be involved in any way with financing competitive product ventures? Insofar as this arrangement increases the likelihood that competitive ventures would receive loans from the Postal Service Fund and thereby be subsidized by and at the expense of postal ratepayers, users of Postal Service monopoly mail products could be penalized. At least on the surface, this seems to be a potential crack in the wall of separation between the two categories. Second, since all the shares of the private law corporation would be owned by the Postal Service, which has control of the Postal Service Fund, any such funds transfer may be difficult to effectively monitor in order to assure prevention of advantageous treatment - to the detriment of marketplace competitors of the private law corporation.

Title Five - Budget and Appropriations Process...MSC supports Title Five.

Title Six - Postal Rates, Classes and Services...MSC enthusiastically endorses the expanded jurisdiction and use of subpoena authority for the PRC with respect to the Postal Service and codifying the inapplicability of subpoena authority to intervenors in PRC proceedings.

MSC questions the proposal for establishing baskets within the noncompetitive category. The price cap system proposed in the Bill correctly uses an exogenous price index, and would apply to it - also correctly - an X - factor reflecting only expected productivity changes. The entire system is aimed at de-coupling rates from costs. That being so, many question why there should be separate baskets for First Class, Periodicals, and Standard Mail.

In any event, MSC is unable to determine any justification for dividing First Class letters into two baskets. Such an artificial distinction was rejected by the PRC in Docket MC95-1, where an attempt was made to grant separate subclass status to automated bulk First Class mail. This would have had the effect of shifting institutional costs to single piece mail. It has long been the case that mail groupings - and the related differences in institutional costs - are to be separated only when and if the mail groupings concerned differ as to the purpose for which they are sent, the type of sender, and the content of the mail. These criteria for establishing mail

groupings for assignment of costs are consistent with the goal of maximizing the social benefits the Postal Service confers. It is that social benefit that justifies the Postal Service letter monopoly. Also it should be the basis for decisions regarding recovery of institutional costs - whose recovery is, essentially, a form of tax and as such should respect the policy behind the monopoly: *maintenance of a public service binding the Nation together*. Where there is no distinction in purpose or content of the mail, there should be no distinction in the way rates are set under the current system of rate making, or under one based on price cap techniques. Finally it should be noted that policies of the Board of Governors and the PRC have fostered the practice of work sharing under which costs are efficiently recovered. First Class mail should remain a single basket because (1) there is no distinction in its purpose or content as between bulk and single piece, and (2) First Class bulk mailers have and should continue to be compensated for their worksharing activities out of the savings those activities generate for the Postal Service. Accordingly, MSC recommends that the Subcommittee reject the proposal of dividing the historic First Class category into separate bulk and single piece baskets.

It should be **fundamental** that - as in the present ratemaking system - discounts available to some and not others must be cost justified. This is true of all discounts, but is particularly important with respect to "volume" discounts. As noted above, if and to the extent it is sound public policy to split Postal Service products into competitive and noncompetitive categories, it follows that authorizing *discriminatory* application of volume discounts among various purchasers of postal products should be limited to competitive products. It is appropriate that such discriminatory volume discount pricing cover not only the attributable costs of such products, but also their "equal proportion" of overhead costs. This, however, raises the same legislative language dilemma mentioned above under Title Four.

In addition, the proposal would permit discounts in the noncompetitive category on a *nondiscriminatory* basis, in accordance with current law. To some MSC members this **draft** language in the concept papers is unclear. It would be enthusiastically supported by MSC if it is intended to provide that there will be no *volume* discounts in the noncompetitive category. On the other hand we would oppose the concept **if it is intended that it would permit volume discounts for the noncompetitive category even if they are made available to all mailers in the affected class or subclass.** MSC opposes volume discounts in this category under any conditions.

In summary, there is a serious question whether product baskets are a relevant approach under the proposed price cap scheme. In any event there should be only one First Class basket and not two. In addition,

volume discounts should not be authorized for noncompetitive postal products under any conditions.

Title Seven - Transportation, Carriage or Delivery of Mail. ..MSC supports this Title.

Title Eight - Merit Systems Protection Board...MSC supports this Title.

Title Nine - Law Enforcement.. .MSC supports this Title.

Title Ten - New System Relating to Postal Rates, Classes, and Services.. .Subchapter One.. .Base Line Case.. . MSC has no objection to the procedure and provisions regarding the establishment of baseline rates and fees, subject to the observations made about the splitting of First Class, to the comments set forth below and to a review of legislative language, as noted above.

Subchapter Two - Noncompetitive Category Rates... The Bill calls for a more clean-cut form of price cap regulation than did earlier versions. This is important, because price cap regulation can work only if the cap is firm (and perceived as such by the regulated entity) and is not subject to being lifted to accommodate cost overruns. The Bill envisions substantially restricting the "X" adjustment in the price cap formula (index minus "X") to the role of a productivity adjustment. Thus, once rates have been escalated above the level set in the baseline case, neither USPS-specific costs nor the particular functional or demand characteristics of the different types of mail would have a role in establishing maximum rates. The price index is unrelated to postal operation costs, and the productivity adjustment is not inherently associated with different types of mail. We also ~~note our concurrence with the exclusive and final authority granted to the~~ PRC to revise the adjustment factor in any rate making cycle. While these represent major improvements over previous proposals, to our knowledge, none of the economists who testified before the Subcommittee has endorsed a price cap regulatory scheme for the Postal Service. Others have also questioned its practical application at the USPS. While the desire to move away from a cost based ratemaking system is certainly, in theory, an appropriate regulatory objective for some industries, we find troubling this current lack of endorsement for a postal price cap scheme, which is one of the linchpins of the Bill. Price caps, because they do depart from close examination of costs, have the potential to become price escalators rather than a means of controlling prices (at least for captive traffic)- especially ~~where the regulated firm faces only limited competition. Moreover,~~ especially in the case of noncompetitive statutory monopoly services, we are

concerned ~~that~~ price caps can lead to service reductions rather than cost reductions. Accordingly, consideration should be given to reassessing this proposal at the current time.

MSC believes there are serious flaws in the proposed 2 percent "deviation" band approach in the Bill, which could lead to a form of Postal Service decision making that must be carefully reviewed, as it may prove to be undesirable. The plus or minus 2 percent "deviation band" as originally proposed appears to create a 4 percentage point area of pricing flexibility around the index. As we understand it, however, it would in fact create a much broader and objectionable area of Postal Service discretion. It is our understanding that the proposed legislative language will in fact permit the Postal Service to raise rates to a level 2 percent higher than the index and to ~~reduce rates by 2 percent from the present level.~~ Thus, ~~for example,~~ if the index is 8 percent (in a period of more rapid inflation), the band would be from plus 10 percent to minus 2 percent, or a 12 percentage point differential. The Postal Service would be able to independently create excessive non-cost related rate differences that it has heretofore failed to obtain ~~from~~ the Postal Rate Commission. With this potentially enormous band, the Postal Service could make staggering changes in rates-changes that are discriminatory by any measure, free from any regulatory or judicial oversight.

MSC would like to be helpful in offering an alternative to the foregoing deviation band problem. Without waiving an objection to deviation band adjustments solely within the discretion of the Postal Service, ~~under conditions where the Postal Service proceeds to reduce a~~ rate by 2 percent, than such action should establish a 2 percent increase cap. For example, if the index were 5 percent and the Postal Service chooses to raise some rates within the basket by 6 percent, than the range of possible rate changes would be plus 2 percent to plus 6 percent.. In other words, under this approach, the Postal Service could in essence create its own 4 percentage point band in any mail group so long as the upper level does not ~~exceed the index by 2 percent.~~ This approach would offer significant flexibility to the Postal Service while protecting mailers from widely disparate treatment.

Subchapter Three - Competitive Category Rates...Please refer to our comments under Title Four (Financing). ~~In addition,~~ MSC concurs with the proposal to grant to the PRC jurisdiction to determine under specified criteria whether a product is non-competitive or competitive. We note that IRS laws and regulations are omitted from those laws that would apply to the new private law corporation. We trust this was an oversight with respect to the competitive products ventures of the new private law corporation.

Subchapter Four - Market Tests...Provision should be made to preclude surreptitious switching of non-competitive products used by favored USPS customer groups to a competitive product test program - for example, by creating a “new” product which is only a superficially altered version of an existing service and making it the subject of a market test. This should not be permitted because during such tests for competitive products are exempt from the general requirement that the rate for each such product should cover its attributable costs.

Subchapter Five - Reporting and Related Requirements...MSC endorses the strengthening of the PRC in this and the other sections of the Bill. The reference in the revisions outlined in this Subchapter to the “attribution of costs and revenues” is confusing. More information is required to develop either comments or a position. In addition, clarifying language is required in order to analyze the “Use of Profits” portion of this Subchapter.

Additions - MSC urges that the suggested additions to the Bill as set forth from page 43 of the attachment to your above mentioned letter be reviewed in a legislative hearing before the Subcommittee. The establishment of a for profit private corporation (USPS Corporation) whose shares would be owned by the Postal Service to engage in the marketing of “non-postal products and services” (but see (d) below) raises a large number of questions from a legal, practical and public policy standpoint, some of which are as follows:

- a) Will the Articles of Incorporation be printed in the Federal Register for comment by the public and be subject to other provisions of the Administrative Procedures Act before filing with the appropriate state;
- b) As a practical matter, even though the USPS Corporation is not set up as an agency of the United States, it will probably be perceived as such, particularly since all shares will be owned by a U.S. agency;
- c) In spite of what appears to be legislative intent to the contrary, would the Postal Service as a legal matter incur liability for the activities of the USPS Corporation. The Board of Directors of the USPS Corporation can be appointed only by the Postal Service Board of Governors. The shares can be purchased only through the Competitive Products Fund. The Competitive Products Fund will have, at least initially, Postal Fund financial support. Authorization is granted for the Postal Service to enter into commercial transactions with the USPS Corporation.

Accordingly, it would seem that a legitimate claim could be made that the **Postal Service** is, in fact, the *alter ego* of the USPS Corporation and as a legal matter may not escape the responsibility for the actions of the USPS Corporation. This is another way of saying that “Aunt Minnie” could be financially liable..at least in part. Even if the Postal Service escapes legal liability, there remains potential for harm to captive mailers: accounting distortions introduced to favor the competitive enterprises, and the diversion of managerial attention from core services to peripheral competitive ventures could cause real harm **that is not remediable legally**;

- d) The concept paper provides that the USPS Corporation may “engage in **any postal** or non-postal business”. This apparently unrestrained grant of authority requires a great deal of clarification. On its face it would suggest the USPS Corporation would have a limitless growth of activity;
- e) With the close linkage between the Postal Service and the USPS Corporation described above, safeguards must be established regarding the authorization of the USPS Corporation to be a customer of the Postal Service.

In summary, a number of questions need to be answered before this concept is advanced **further** in the legislative **process**. In fairness, we do not mean to prejudge the proposal; we strongly believe, however, that we must submit our reservations about the impact a USPS Corporation could have on the Postal Service and correspondingly on our members.

Several MSC members also have raised questions about the proposal for the PRC to investigate the concept of universal service. For the small mailers, there is genuine concern about where this might lead and the purpose of the inquiry. Indeed, the purpose is nowhere made clear, and the emphasis on quantification leads to the suspicion that at least some components of service to small users and to rural areas may be put at risk. It is also questionable whether the FCC inquiry into requirements for universal service by private, profit making firms in an increasingly competitive industry is a good model in the postal context. Some “living concepts” like freedom of speech, for example, are best defined on a case by case basis. It may be that universal service - or its absence - is such a concept and should be monitored on an on-going basis before a Postal Regulatory Commission.

Mr. Chairman, we look forward to reviewing the legislative language and finalizing for your Subcommittee our comments and suggestions.

Respectfully submitted,

Main Street Coalition

cc: Members of the Subcommittee
Members of the Board of Governors of the Postal Service
Members of the Postal Rate Commission